SOUNDTRANSIT

Central Puget Sound Regional Transit Authority

Single Audit Reports for the Year Ended December 31, 2007

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AUDITED FINANCIAL STATEMENTS

MANAGEMENT'S DISCUSSION AND ANALYSIS

For the years ended December 31, 2007 and 2006

Management's Discussion and Analysis ("MD&A") presents a narrative overview and analysis of the financial activities of the Agency for the years ended December 31, 2007 and 2006. The MD&A is designed to assist readers of financial statements in focusing on significant financial activities and issues and to identify any significant changes. As this information is presented in summary form, it should be read in conjunction with the financial statements and footnotes as a whole.

Central Puget Sound Regional Transit Authority, a public corporation acting under the service name of Sound Transit, is a regional transit authority implementing and providing a high-capacity transportation system throughout parts of King, Pierce and Snohomish counties through commuter rail ("Sounder"), light rail ("Link") and a regional express bus system ("ST Express"). The implementation of the initial phase of the voter-approved regional transportation system ("*Sound Move*") is scheduled for a 20-year period, ending in 2016. In anticipation of a full funding grant agreement for University Link, this represents an extension of the Ten-Year Regional Transit System Plan previously scheduled to complete in 2009. The agency's activities to date have been concentrated on implementing service in all three-transit modes and on the design, environmental review and construction of its capital projects.

Sound Transit's financial statements have reflected a growth in operating revenues and expenses each year, as well as growth in capital projects in progress and property, vehicles and equipment. As the Agency has not reached its full service levels and is in the construction phase on its light rail project, major sources of revenue exceed expenses resulting in a rising net asset position.

Financial Highlights

- Total operating revenues were $26.2 million for 2007, an increase of 22.3% from the prior year. Passenger fares increased by $3.9 million from the prior year as a result of providing additional round-trip Sounder service and large ridership gains on Sounder and ST Express.

- Loss from operations was $125.4 million for 2007, an increase of 4.8% from the prior year. Operations and maintenance expenses increased by 11.2% reflecting the increased service levels, as well as unit cost increases in the price of fuel and labor and higher maintenance costs. General and administrative expenses, after allocations to capital projects and operations and maintenance, decreased by 7.6%. The prior year included a write-off of general and administrative costs of $2.4 million.

- Non-operating revenues net of expenses were $352.6 million, and were comparable to the prior year. Tax revenues increased by 7.1% as the regional economy continued to perform strongly in 2007. However, interest revenues decreased and non-operating expenses increased as the agency incurred start-up costs in preparation for Link light rail service in 2009; increased legal costs related to construction claims; and costs incurred for east Link corridor planning.

- Federal, state and local contributions to Sound Transit of $117.4 million decreased by 18.8 % from the prior year while completed projects transferred to other governments of $115.6 million increased by $42.8 million or 58.8 %. These changes reflect lower grant and local funds received in the current year

for Sounder and Sound Transit Express projects, as these programs approach completion, and the completion of the Totem Lake Freeway Station/NE 128th Project ($67.9 million).

- Total net assets at December 31, 2007, were $2.9 billion, an increase of $229.0 million or 8.6% from 2006. This change was down from 2006, during which net assets increased by $302.6 million or 12.9%, reflecting the increase in completed projects transferred to other governments.
- Total capital assets, net of accumulated depreciation, were $3.5 billion at December 31, 2007, an increase of $583.6 million or 20.3% from 2006. The increase in total capital assets reflects continued progress on the Link light rail project, land acquisitions for light rail extension to the University of Washington, acquisition of the 4th and final easement for Sounder Service in the north corridor and Sounder track and facilities improvements. In 2007, $183.6 million in expenditures related to rail access rights and completed projects was transferred to depreciable assets.

Overview of the Financial Statements

Sound Transit's financial statements are prepared in conformity with United States generally accepted accounting principles ("GAAP") as applied to government units. The 2007 and 2006 financial statements are presented using the economic resource measurement focus and accrual basis of accounting. As Sound Transit comprises a single proprietary fund, no fund level financial statements are shown.

In accordance with GAAP, all revenues are recognized in the period in which they are earned and expenses are recognized in the period in which they are incurred. All assets and liabilities associated with the operation of Sound Transit are included in the Balance Sheets, and depreciation of capital assets is recognized in the Statements of Revenues, Expenses and Changes in Net Assets.

The financial statements provide both long-term and short-term information about Sound Transit's overall financial status as well as Sound Transit's net assets, segregated by invested in capital assets (net of related debt), restricted and unrestricted. Net assets are the difference between Sound Transit's assets and liabilities and over time may serve as a useful indicator of Sound Transit's financial position. The financial statements also include notes that provide additional information that is essential to a full understanding of the information provided.

Financial Analysis

Net Assets

Sound Transit's total net assets at December 31, 2007, were $2.9 billion, an increase of $229.0 million or 8.6% from 2006 (see Table A-1). Total assets increased $707.7 million or 19.3% and total liabilities increased by $478.7 million or 46.9%. Assets and liabilities increased as bonds were issued in December 2007 with the balance of the increase in total assets substantially attributable to capital-spending activity. This compares to total net assets of $2.6 billion at December 31, 2006.

Table A-1

Sound Transit Net Assets

(in millions)	As of December 31, 2007			% Change	
	2007	**2006**	**2005**	**2007-2006**	**2006-2005**
Current assets, excluding restricted assets	$ 730.3	$ 587.1	$ 679.5	24.4	(13.6)
Restricted assets	120.2	142.1	335.3	(15.4)	(57.6)
Capital assets	3,454.0	2,870.4	2,277.5	20.3	26.0
Other non-current assets	70.7	67.9	74.9	4.1	(9.3)
Total Assets	**4,375.2**	**3,667.5**	**3,367.2**	**19.3**	**8.9**
Current liabilities, excluding interest payable from restricted assets	190.6	162.9	155.0	17.0	5.1
Interest payable from restricted assets	11.2	10.5	10.6	7.0	(0.7)
Long-term debt	1,226.3	779.8	791.2	57.3	(1.4)
Other long-term liabilties	70.8	67.0	65.7	5.5	2.0
Total Liabilities	**1,498.9**	**1,020.2**	**1,022.5**	**46.9**	**(0.2)**
Net Assets					
Invested in capital assets, net of related debt	2,216.8	2,085.8	1,674.9	6.3	24.5
Restricted net assets	109.0	131.6	131.8	(17.2)	(0.2)
Unrestricted net assets	550.5	429.9	538.0	28.1	(20.1)
Total Net Assets	**$ 2,876.3**	**$ 2,647.3**	**$ 2,344.7**	**8.6**	**12.9**

Current assets, excluding restricted assets, increased in 2007 by 24.4% from 2006. This increase was due to higher cash and cash equivalent balances on hand with the receipt of bond proceeds in December 2007, which were considered fully spent upon issuance. Current assets, excluding restricted assets, decreased in 2006 by 13.6%, with a decrease in investments of $256.9 million as the agency funded its construction activity as well as lower receivables of $17.1 million.

Restricted assets decreased in 2007 by 15.4% from 2006, as payments were made out of funds restricted for BNSF for improvements required in the Seattle-to-Tacoma Sounder corridor. In 2006, restricted assets decreased by 57.6% as funds related to the 2005 bond issuance were expended, as well as payments to BNSF pursuant to contractual agreement.

Capital assets increased in 2007 by 20.3% from 2006. Of that, construction in progress increased by $435.0 million, primarily on the Link light rail projects, the first segments of which are scheduled to go into service in July 2009. In 2007, Sound Transit capitalized $737.6 million ($707.2 million in 2006) in design, construction, acquisition, interest and general and administrative costs allocated to capital projects in progress. The Central Link and Airport Link light rail projects are in full construction, representing $552.4 million of amounts capitalized in 2007 or 74.9% of total capital spending ($530.7 million in 2006 or 75.0%). The Sounder and ST Express programs are approaching completion of several major program elements. Other additions to capital assets include land, primarily for the University Link segment, and the acquisition of the fourth and final permanent easement for Sounder service in the north corridor.

Management's Discussion and Analysis, continued

Transfers out of capital projects in progress were $302.6 million ($235.9 million in 2006) as projects were completed and transferred to property, vehicles and equipment or expensed as follows:

(in millions)	2007	2006
Transferred to property, vehicles and equipment	$ 183.6	$ 154.8
Expensed to contributions to other governments	114.4	72.8
Link start-up expenditures	4.0	-
Write-off of overhead, discontinued and impaired project costs and loss on disposal of assets	0.6	8.3
	$ 302.6	**$ 235.9**

In 2007, write-offs included $211 thousand related to the Meadowdale dock mitigation project in Shoreline that was not pursued, and $349 thousand in overhead costs were written off. In 2006 structural cracking related to a design error was identified on the Totem Lake Freeway Station project and $5.9 million in costs were considered impaired and were written off. Also written off in 2006 was $2.4 million in overhead, including $1.4 million related to the Tukwila Sounder station, as full build out of the permanent station was postponed to the second phase of *Sound Move*.

Direct additions to property, vehicles or equipment in 2007 were $4.7 million, which included the acquisition of seven new 45' diesel buses to be operated by Pierce Transit. In 2006 direct additions were $2.2 million and included $1.3 million in transit facilities and equipment, $0.2 million in administrative fleet vehicles, and $0.7 million in furniture and office equipment.

Offsetting the increase in capital spending were disposals and transfers of $4.6 million, which included land held for resale of $3.9 million and $263 thousand related to the replacement of the back office system for the ticket vending machines and accumulated depreciation, which increased in 2007 by $35.1 million. In 2006 disposal and transfers were $2.2 million, primarily related to land from the Federal Way Transit Center project moved to held for resale or capitalized to the project and accumulated depreciation increased by $33.4 million.

Current liabilities, in 2007, excluding interest payable from restricted assets, increased by 17.0% as higher amounts were payable at year-end for the Beacon Hill tunnel and Link vehicle contracts, the construction claim provision was increased and the current portion of long-term debt increased as amounts for principal due in 2008 for the 2007A Bonds. Current liabilities in 2006 increased by 5.1%, reflecting a significant increase in other liabilities related to increased construction claims, which more than offset decreased accounts payable as several Link construction contracts approached completion.

Long-term debt increased by 57.3% with the issuance of the 2007A Bonds for $450 million, less principal payments for principal due on the 1999 Bonds and the final $6 million promissory note to BNSF. In 2006, long-term debt decreased by 1.4% reflecting principal payments on the 1999 Bonds and a $6.0 million promissory note payment to BNSF.

The following table presents the net asset components and their relative percentage to total net assets:

Net Assets

(in millions)	As of December 31,			% Total Net Assets		
	2007	**2006**	**2005**	**2007**	**2006**	**2005**
Invested in capital assets, net of related debt	$ 2,216.8	$ 2,085.8	$ 1,674.9	77.1	78.8	71.4
Restricted net assets	109.0	131.6	131.8	3.8	5.0	5.6
Unrestricted net assets	550.5	429.9	538.0	19.1	16.2	23.0
Total Net Assets	**$ 2,876.3**	**$ 2,647.3**	**$ 2,344.7**	**100.0**	**100.0**	**100.0**

For years 2005 through 2007, the components of Sound Transit's net assets, which represent the cumulative effect of the excess of revenues over expenses, together with the impact of the agency's financing and asset management decisions, remain comparable. Invested in capital assets reflects investment in property, construction in progress and depreciable net assets used in its operations, while restricted net assets are assets restricted for use by the agency for a specific purpose and unrestricted net assets are the remainder of net assets not invested in capital nor restricted for a specific purpose.

Changes in Net Assets

Changes in net assets reflect the excess of revenue over expenditures for a year. In 2007, the excess of revenues over expenses was $229.0 million, while in 2006 it was $302.6 million (see Table A-2). The lower net revenues in 2007 from the prior year primarily relates to lower capital contributions as the agency transferred several completed projects to other local governments or the State. In 2006, higher non-operating revenues and expenses contributed to net revenues exceeding 2005.

Management's Discussion and Analysis, continued

The agencies statement of revenue, expenses and changes in net assets is summarized in the table below:

Table A-2

Changes in Sound Transit Net Assets

(in millions)	For the Year Ended December 31,			% Change	
	2007	**2006**	**2005**	**2007-2006**	**2006-2005**
Operating Revenues					
Passenger fares	$ 22.0	$ 18.1	$ 16.5	22.0	9.5
Other	4.2	3.4	3.4	23.4	1.6
Total Operating Revenues	26.2	21.5	19.9	22.3	8.2
Operating Expenses					
Total operating expenses, before depreciation and loss on disposal of assets	116.2	107.6	97.8	8.0	10.0
Depreciation and loss on disposal of assets	35.4	33.5	34.5	6.0	(2.9)
Total operating expenses	151.6	141.1	132.3	7.5	6.7
Loss from operations	(125.4)	(119.6)	(112.4)	4.8	6.4
Non-operating revenues, net of expenses	352.6	350.4	311.7	0.6	12.4
Income before capital contributions	227.2	230.8	199.3	(1.5)	15.8
Capital contributions	1.8	71.8	86.6	(97.5)	(17.1)
Change in Net Assets, before cumulative effect adjustment	229.0	302.6	285.9	(24.3)	5.8
Cumulative effect adjustment	-	-	(0.2)	-	-
Change in Net Assets	229.0	302.6	285.7	(24.3)	5.9
Total net assets, beginning	2,647.3	2,344.7	2,059.0	12.9	13.9
Total Net Assets, ending	$ 2,876.3	$ 2,647.3	$ 2,344.7	8.7	12.9

Operating Revenues

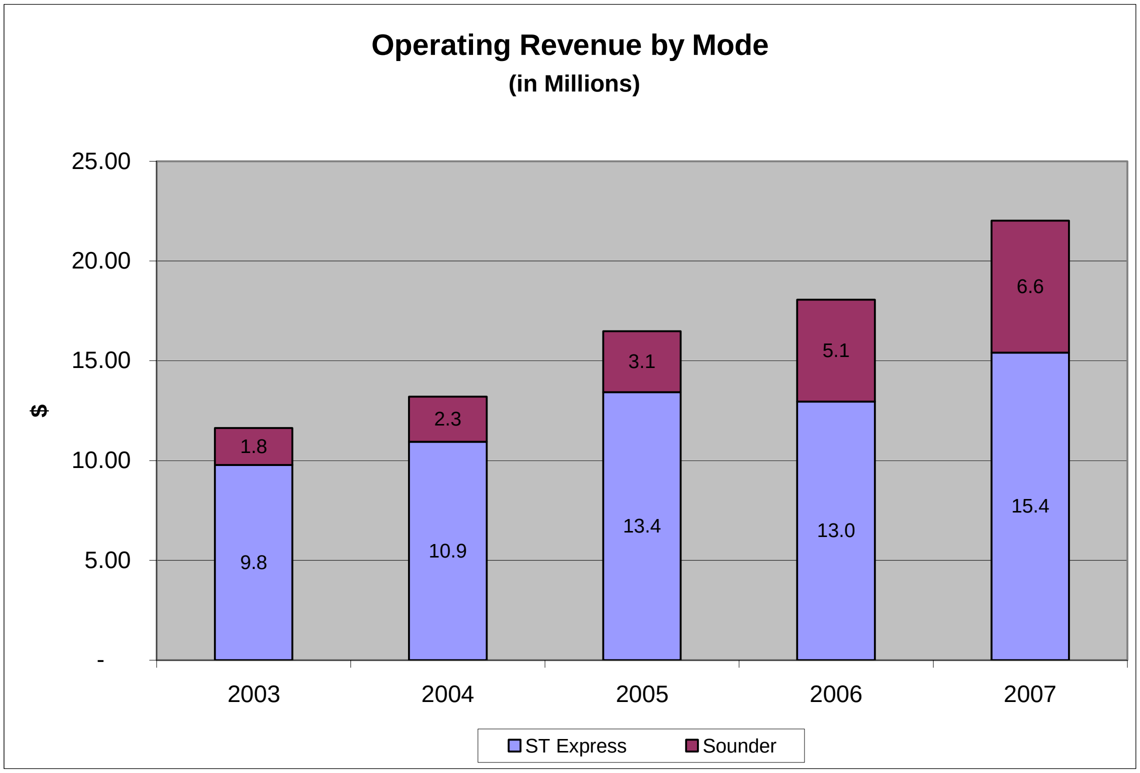
Operating revenues are composed of passenger fares and other revenue related to operations.

Passenger Fare Revenue

Passenger fare revenue consists of fares earned from the sale of Puget Passes, Sounder tickets and bus farebox receipts from riders on Sounder and ST Express during the year. The agency experienced overall growth in passenger fares revenue of 22.0%, passenger boardings of 12.3% and its average fare per boarding (AFB) of 8.0%.

Management's Discussion and Analysis, continued

The following chart displays revenue by mode from 2003 to 2007:



Sounder rail passenger revenue increased $1.5 million or 29.6% in 2007, compared to $2.0 million or 67.3% in 2006 as the service experiences growing ridership in both years and a higher earned average fare per boarding in 2006. The ridership increase in 2007 and 2006 reflects both higher per train ridership and additional round-trip service, the effect of which was an increase in boardings of 27.4% in 2007 and 33.5% in 2006. The two-week I-5 freeway closure in August contributed to a large influx of new riders during that period, which continued after the closure. On the South line, round-trip service was added between Auburn-to-Seattle for the month of August 2007 and between Tacoma-to-Seattle in September 2007 and 2005, as well as a reverse commute September 2007. On the North line, round trip service was added between Everett-to-Seattle in September 2007 and June 2005.

The average fare per boarding on Sounder in 2007 at $3.07, increased by $0.05, and also increased significantly in 2006. In June 2007, the agency restructured its fare system to distance based fares together with a fare increase. The 2006 increase related to a change in the methodology for allocation between Sounder and ST Express.

ST Express bus passenger revenue increased by $2.4 million or 19.0% in 2007, as compared to a decrease in 2006 of $0.4 million or 3.6%. The increase in 2007 was driven primarily by growing ridership as well as a higher earned average fare per boarding. Ridership on ST Express throughout the system was favorably impacted in both 2007 and 2006, increasing by 1.0 million boardings or 10.5 % in 2007 and 862 thousand boardings or 9.8% in 2006. The rising cost of fuel and increased congestion in the region, has made public

transportation a more attractive alternative. In addition, service route enhancements were implemented on the Issaquah – Seattle and Lakewood – Seattle routes in 2007 and in 2006 a new route was implemented between Federal Way and Seattle. In 2007 and 2006 service hours increased by approximately 4.5 and 3.0%, respectively.

The average fare per boarding on ST Express in 2007 at $1.44, increased by of $0.10 or 7.8%, however had decreased in 2006 due to the change in allocation methodology between ST Express and Sounder. The last fare increase for ST Express was in 2005 when fare prices were increased by $0.25, effective in June of that year.

Ridership on Tacoma Link, a free fare service, showed moderate increases in 2007 from prior 2006 and 2005, which were comparable.

Ridership numbers by year and mode of transportation are as follows:

Ridership

(in thousands)				% Increase	
	2007	**2006**	**2005**	**2007-2006**	**2006-2005**
Sounder	2,156.7	1,693.0	1,268.0	27.4	33.5
Link	919.0	885.6	884.9	3.8	0.1
ST Express	10,689.0	9,677.6	8,815.8	10.5	9.8
Total	**13,764.7**	**12,256.2**	**10,968.7**	**12.3**	**11.7**

Other Operating Revenues

Other operating revenues consist of vehicle advertising, rental of equipment and facilities and other miscellaneous revenue. Other revenues of $4.2 million, increased by 23.4% in 2007, while in 2006 were comparable to the prior year. This increase was primarily in advertising and reflected a successful advertising program initiative.

Operating Expenses

Operating expenses are comprised of operations and maintenance costs, general and administrative expenses and depreciation.

Operations and Maintenance

Operations and maintenance expenses for all transit modes, increased in 2007 by $10.0 million or 11.2% and by $8.0 million or 9.9% in 2006. Major expense categories are services, materials, supplies, utilities, insurance, taxes, and purchased transportation, allocated overhead from staff divisions and operating leases and rentals. Purchased transportation represents amounts paid to BNSF, Community Transit, King County Department of Transportation and Pierce Transit who operate Sound Transit's commuter rail and express bus service, accounting for 70% of this category. Services are the next largest expenditure in this category and include the Sounder vehicle maintenance contracted to Amtrak and various contracts for facilities maintenance at Sound Transit-owned facilities.

Operations and maintenance costs by mode are as follows:

Operations and Maintenance
(in millions)

	2007	2006	2005	% Increase 2007-2006	% Increase 2006-2005
Sounder	$ 24.8	$ 22.7	$ 21.1	9.5	7.8
Link	3.2	2.9	2.8	8.6	3.4
ST Express	71.1	63.5	57.2	11.9	11.0
Total	**99.1**	**89.1**	**81.1**	**11.2**	**9.9**

The operating and maintenance cost increase on Sounder was 9.5% in 2007 and 7.8% in 2006 and on ST Express was 11.9% in 2007 and 11.0% in 2006. These increases reflect the service increases and corridor improvements previously described which on Sounder equated to a 14.6% increase in trips in 2007 and a 15.2% increase in 2006 and on ST Express a 4.5% increase in hours in 2007 and a 3.1% increase in 2006. Rising fuel costs also contributed to increased costs in both years, as well as higher maintenance costs on ST Express as the fleet ages.

General and Administrative

General and administrative expenses are comprised of Agency staff and administrative costs not allocated to operations and maintenance or to capital projects. Major expense categories include wages, benefits, services, materials, supplies, utilities, insurance, taxes, miscellaneous, lease and rental expenses. In 2007, net general and administrative expenses decreased by $1.4 million or 7.6%, while in 2006, they increased by $1.8 million or 10.7%**.**

General and Administration
(in millions)

	2007	2006	2005	% Increase 2007-2006	% Increase 2006-2005
Total General and Administrative cost before allocations	$ 48.6	$ 46.0	$ 46.2	5.7	(0.5)
Allocations to Operations	(6.9)	(6.5)	(5.9)	5.8	10.5
Allocations to Capital Projects	(25.0)	(23.4)	(24.2)	7.0	(3.3)
Project overhead written off	0.4	2.4	0.6	(81.6)	296.0
Net General and Administrative	**17.1**	**18.5**	**16.7**	**(7.6)**	**10.7**

Before allocation to capital projects and operations, total agency staff and administrative costs increased by $2.6 million or 5.7%, primarily in the salary benefits, services, materials and supplies. Costs increased in the salary and benefit, services and material and supplies categories. Total general and administrative expenses in 2006 were comparable.

General and administrative costs allocated to capital projects and transit operations include staff-related costs of those divisions and an allocation of agency overhead. Total general and administrative costs allocated to capital projects and transportation services of $31.9 million increased in 2007 by $2.0 million, mostly to the light rail project, which was in its peak construction period, as well as to transportation services reflecting increased operations service. Total general and administrative costs allocated to capital

projects in 2006 were comparable to 2005; however, in 2006 more costs were allocated to transportation services as service increased.

As projects approach completion, allocated overhead costs are reviewed, and any excess costs or costs with no continuing value are written off. Costs written off in 2006 were higher than in 2007 and 2005 as 2006 included $2.4 million related to the postponement of construction of the Tukwila Sounder Station.

Depreciation

Depreciation expense increased in 2007 by $1.9 million or 6.0% from the prior year, but decreased in 2006 by $1.0 million. The increase in 2007 reflects continued capitalization of the track and facility improvements in the South corridor for Sounder, as well as the capitalization of the Link Operations and Maintenance Facility, which is now in use in preparation for start-up. The reduction in 2006 reflected certain assets that are continuing to be left in service for a few additional years.

Non-Operating Revenues (Expenses)

Non-operating revenues (expenses) are substantially comprised of tax revenues, investment income and certain expenses not related to operation of the agency's three modes of operations. Net non-operating revenues were comparable in 2007 to the prior year, however increased in 2006 by $38.7 million or 12.4%.

Non-operating Revenues and Expenses

(in millions)				% Increase	
	2007	**2006**	**2005**	**2007-2006**	**2006-2005**
Non-operating revenues					
Sales tax	$ 280.3	$ 259.2	$ 239.8	8.1	8.1
Motor vehicle excise tax	72.4	70.2	66.3	3.1	5.9
Rental car tax	2.5	2.4	2.2	4.3	8.1
Investment income	25.0	37.3	26.1	(33.1)	42.9
Other revenues	0.1	(0.0)	0.0	-	-
Total	**$ 380.3**	**$ 369.1**	**$ 334.4**	**3.0**	**10.4**
Non-operating Expenses					
Non-operating expense	27.3	12.4	15.8	120.3	(21.7)
Interest expense	0.2	0.4	0.2	(48.7)	186.5
Discontinued/impaired projects	0.2	5.9	6.3	(96.5)	(6.1)
Loss on disposal of assets	-	-	0.4	-	(100.0)
Total	**27.7**	**18.7**	**22.7**	**47.6**	**(17.5)**
Non-operating Revenues and Expenses	**352.6**	**350.4**	**311.7**	**0.6**	**12.4**

The most significant impact on non-operating revenues has been stronger tax revenues, that improved by $23. 4 million in 2007 and $23.5 million in 2006. This performance reflects the continued strengthening of the regional economy from prior years. Investment earnings, however decreased by $12.3 million as during the year the agency utilized its cash and investment balances for its construction program. In 2006, investment earnings were $11.2 million higher than in 2005 as interest rates improved from the prior year and higher cash and investment balances were on hand.

Other non-operating expenses include light rail operation start-up costs, east corridor planning, supplemental mitigation in the Rainier Valley, costs not eligible to be capitalized, interest expense and discontinued and impaired project costs. In 2007, the agency moved into preparations for start-up of light rail, as well as increased east corridor planning, supplemental mitigation and costs related to construction claim support. In 2006, there were fewer Phase II planning costs than anticipated due to the delay in the ballot measure for ST2, which was postponed to 2007.

Capital Contributions

Net capital contributions decreased in 2007 by $70.0 million, reflecting the significant increase in contributions to other governments with the completion of several large non-ST owned projects. In 2006, net capital contributions decreased by $14.8 million. Capital contributions include federal grant funding, state and local contributions to Sound Transit, as well as contributions from Sound Transit to state and local governments pursuant to capital improvement or funding agreements. The following table summarizes capital contributions by major category:

Capital Contributions

(in millions)				% Increase	
	2007	**2006**	**2005**	**2007-2006**	**2006-2005**
Federal	$ 112.7	$ 130.5	$ 135.4	(13.6)	(3.6)
State and local governments	4.7	14.1	7.1	(66.8)	98.5
To other goverments	(115.6)	(72.8)	(55.9)	58.8	30.2
Total	**$ 1.8**	**$ 71.8**	**$ 86.6**	**(97.5)**	**(17.1)**

Federal contributions decreased in 2007 by $17.8 million and by $4.9 million in 2006. Grant funding reimbursements for the Central Link project were slightly up in 2007, however are down for the ST Express and Sounder projects, the programs of which are approaching completion for Phase 1. Grant funding reimbursements were also up in 2006 for the Central Link project and ST Express projects, but were down for Sounder projects as 2005 included the receipt of $24.4 million for the Everett-to-Seattle Corridor projects.

State and local government contributions decreased in 2007 by $9.4 million, as 2006 contributions included $8.8 million from the Port of Tacoma and the City of Tacoma related to the D Street to M Street project, $1.0 from the City of Issaquah for the Issaquah Transit Center project and $3.2 million in State Land Bank contributions.

As Sound Transit approaches the end of its Phase 1 projects for its ST Express projects, the value of contributions to other governments has been increasing. In 2007, Sound Transit completed the Totem Lake Freeway Station/NE 128th project of which $67.9 million is included above. Other significant projects included the completion of the Reservation – Freighthouse Square mitigation, Redmond Transit Center/NE 83rd and the SR-522 HOV Enhancements at Kenmore and Bothell. In 2006, project funding provided or projects completed for other governments included: Federal Way HOV Access/317th; Eastgate Transit Access/142; and Sammamish Park and Ride/228th SE. As contributions are dependent upon the timing and scope of project activities there may be significant fluctuations from year to year.

Capital Assets

As of December 31, 2007, Sound Transit had invested $3.5 billion in capital assets, net of accumulated depreciation, which included $762.9 million of depreciable assets in service. This represents a $583.6 million or 20.3% increase over 2006.

Table A-3

Sound Transit Capital Assets *(net of depreciation)*

(in millions)	As of December 31, 2007	2006	2005	% Change 2007-2006	2006-2005
Land	$ 326.6	$ 290.9	$ 269.1	12.3	8.1
Permanent easements	267.2	216.7	161.0	23.3	34.6
Capital projects in progress					
Sound Transit	2,043.2	1,558.5	1,071.1	31.1	45.5
Other governments	54.1	103.8	119.9	(47.9)	(13.4)
Total Non-Depreciable Assets	2,691.1	2,169.9	1,621.1	24.0	33.9
Buildings, transit facilities & rail	290.1	236.2	206.9	22.8	14.1
Rail access rights	305.1	288.9	262.6	5.6	10.0
Revenue vehicles	164.5	172.1	182.8	(4.4)	(5.9)
Equipment, vehicles & other	3.2	3.3	4.1	(2.6)	(19.6)
Total Depreciable Assets	762.9	700.5	656.4	8.9	6.7
Total Net Capital Assets	**$ 3,454.0**	**$ 2,870.4**	**$ 2,277.5**	**20.3**	**26.0**

Land increased by $35.7 million in 2007, primarily related to acquisition for the University Link extension. In 2006, land increased by $21.8 million which included transfers or purchases of $17.8 million for Sounder stations and $6.1 million in properties along the Central Link segment. The significant additions for Sounder include a transfer from capital projects in progress of the balance of the cost of the Nisqually to Lakewood South Line and land for the South Tacoma Station.

Permanent easements increased in 2007 by $50.5 million and by $55.7 million in 2006 with the acquisition of the third and fourth easements from BNSF in the Everett-to-Seattle corridor for $50.0 million in 2006 and 2007 respectively. In addition, in 2006 a permanent easement was acquired from the Port of Seattle for the Airport Link project for $5.7 million.

Management's Discussion and Analysis, continued

Activity on capital projects in progress is summarized in the following table:

Table A-4

Major capital project activities from 2007 and 2006:

	Sounder	Link	ST Express
2007	▪ Track and signal projects on Everett to Seattle; Seattle to Auburn; and Auburn to Tacoma ▪ Lakewood Station	▪ Central Line (CPS to 154th; Downtown & Beacon Hill tunnels; Martin Luther King Way) ▪ Tukwila Alignment ▪ Airport Link (154th to 160th; and 160th to 170th) ▪ North Link (PSST to UW Station) ▪ Beacon Hill Station ▪ Traction Power System ▪ Operations and Maintenance Base ▪ Light Rail Vehicles	▪ Issaquah Transit Center ▪ South Everett Freeway Station ▪ Totem Lake Freeway Station/NE128th
2006	▪ Track and signal projects on Everett to Seattle; Seattle to Auburn; Auburn to Tacoma; and D street to M Street	▪ Central Line (CPS to 154th; Downtown & Beacon Hill tunnels; Martin Luther King Way) ▪ Tukwila Alignment ▪ Airport Link (154th to 160th; and 160th to 170th) ▪ North Link (UW to Brooklyn) ▪ Beacon Hill & McClellan Stations ▪ E3 Busway ▪ Traction Power System ▪ Operations and Maintenance Base ▪ Light Rail Vehicles	▪ Totem Lake Freeway Station/NE128th ▪ Eastgate Transit Access ▪ Issaquah Transit Center ▪ Mercer Island Park and Ride

Buildings, transit facilities, and rail, net of depreciation, increased in 2007 by $53.9 million, primarily related to the capitalization of the Link Operations and Maintenance Facility. In 2006 they increased by $29.3 million with the capitalization of the Federal Way Transit Center and the Sammamish Park and Ride.

Rail access rights, net of depreciation, increased by $16.2 million in 2007 and by $26.3 million in 2006. Rail access costs reflect the cost of acquiring rights from BNSF for the Tacoma-to-Seattle and Everett-to-Seattle segments. In the Tacoma-to-Seattle corridor, these rights are acquired in an amount equal to the funding of necessary track and signal improvements on the line. As the agency is utilizing the rail, these costs are capitalized as charges are incurred.

Revenue vehicles, net of depreciation, and equipment, vehicles and other decreased in 2007 and 2006 as depreciation charges were in excess of additions.

More detailed information about Sound Transit's capital assets is presented in Note 5 to the Financial Statements.

Long-Term Debt

In December 2007, the agency issued sales tax bonds with a par value of $450.0 million at a premium of $17.0 million for net proceeds before bond issue costs of $467.0 million. Total bond issue costs were $3.1 million.

Under state law, issuance of bonds payable from any type of taxes is subject to statutory debt limitations. Sound Transit is currently authorized to incur debt in an amount equal to 1-1/2 percent of the value of

taxable property within the service area, without securing voter approval for bonds. With the approval of 60 percent of the region's voters, Sound Transit may incur aggregate indebtedness of up to 5 percent of the value of taxable property within the service area. Based on the 2006 assessed valuations for collection of 2007 taxes, Sound Transit's non-voter approved remaining debt capacity is $3.7 billion and its voter approved remaining debt capacity is $15.0 billion.

Economic Conditions

Sound Transit continues to experience increases in prices of construction commodities and labor. The average construction cost inflation from 2006 to 2007 was about 7.5% – the same average annual growth rate since 2003. Although the Agency expects to see continuing pressure on construction prices, the impact should diminish in the future as worldwide supply and demand come into closer balance.

Tax-based revenues have held up well with 2007 receipts increasing 7.1% over 2006. There is evidence of some slowing of economic growth in the Puget Sound Region. However, economic activity remains fairly stable and it appears that the region will not be impacted by a recession.

KPMG LLP
Suite 900
801 Second Avenue
Seattle, WA 98104

Independent Auditors' Report

Audit and Reporting Subcommittee of the Board of Directors
Central Puget Sound Regional Transit Authority:

We have audited the accompanying basic financial statements of Central Puget Sound Regional Transit Authority (a public corporation acting under the service name of Sound Transit) as of and for the years ended December 31, 2007 and 2006, as listed in the table of contents. These financial statements are the responsibility of Sound Transit's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to the financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of Sound Transit's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Sound Transit as of December 31, 2007 and 2006 and its changes in financial position and its cash flows for the years then ended in conformity with U.S. generally accepted accounting principles.

In accordance with *Government Auditing Standards*, we have also issued our reports dated June 19, 2008, on our consideration of Sound Transit's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of those reports is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. Those reports are an integral part of an audit performed in accordance with *Government Auditing Standards* and should be read in conjunction with this report in assessing the results of our audits.

The Management's Discussion and Analysis on pages 1 through 14 is not a required part of the financial statements, but supplementary information required by U.S. generally accepted accounting principles. We have applied certain limited procedures, which consisted principally of inquires of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit this information and express no opinion on it.

KPMG LLP

June 19, 2008

BALANCE SHEETS

(in thousands)	December 31 2007	2006
ASSETS		
Current Assets		
Cash and cash equivalents *(Note 3)*	$ 600,319	$ 215,768
Restricted assets *(Note 3)*	6,651	7,919
Investments *(Note 3)*	23,165	280,095
Taxes and other receivables *(Notes 4)*	96,310	79,231
Other	10,478	12,055
Total Current Assets	**736,923**	**595,068**
Non-Current Assets		
Capital assets, net of accumulated depreciation *(Note 5)*	3,453,991	2,870,397
Restricted assets *(Note 3)*	113,540	134,190
Investment held to pay capital lease obligation *(Note 6)*	60,770	59,925
Unamortized bond issuance costs	8,677	6,015
Prepaid expense, deposits and other receivables	1,228	1,946
Total Non-Current Assets	**3,638,206**	**3,072,473**
Total Assets	**$ 4,375,129**	**$ 3,667,541**
LIABILITIES AND EQUITY		
Current Liabilities		
Accounts payable and accrued liabilities *(Note 7)*	$ 116,436	$ 100,544
Deferred receipts	1,618	3,594
Interest payable from restricted assets	11,245	10,511
Current portion, long-term debt *(Note 8)*	19,175	10,246
Current portion, capital lease obligation *(Note 6)*	228	191
Other claims and environmental obligations	53,125	48,310
Total Current Liabilities	**201,827**	**173,396**
Non-Current Liabilities		
Long-term debt *(Note 8)*	1,226,285	779,828
Capital lease obligations *(Note 6)*	60,968	60,270
Other long-term obligations *(Note 9)*	9,781	6,767
Total Non-Current Liabilities	**1,297,034**	**846,865**
Total Liabilities	**1,498,861**	**1,020,261**
Commitments and Contingencies *(Notes 6, 9, 11, 12)*		
Net Assets		
Invested in capital assets, net of related debt	2,216,783	2,085,802
Restricted for contractual arrangements and other *(Note 10)*	108,946	131,599
Unrestricted	550,539	429,879
Total Net Assets	**2,876,268**	**2,647,280**
Total Liabilities and Net Assets	**$ 4,375,129**	**$ 3,667,541**

See Notes to Financial Statements.

STATEMENTS OF REVENUES, EXPENSES AND CHANGES IN NET ASSETS

(in thousands)	December 31	
	2007	**2006**
Operating Revenues		
Passenger fares	$ 22,029	$ 18,052
Other operating revenue	4,234	3,431
Total Operating Revenues	**26,263**	**21,483**
Operating Expenses		
Operations and maintenance	99,113	89,134
General and administrative	17,060	18,471
Loss on disposal of assets	309	3
Depreciation, amortization and accretion	35,187	33,486
Total Operating Expenses	**151,669**	**141,094**
Loss from Operations	**(125,406)**	**(119,611)**
Non-Operating Revenues (Expenses)		
Sales tax	280,263	259,164
Motor vehicle excise tax	72,403	70,202
Rental car tax	2,531	2,427
Investment income	24,952	37,277
Other revenues	119	62
Non-operating expenses	(27,220)	(12,358)
Interest expense	(224)	(436)
Discontinued and impaired projects	(211)	(5,944)
Total Non-Operating Revenues, Net	**352,613**	**350,394**
Income Before Capital Contributions	**227,207**	**230,783**
Capital contributions to other governments	(115,557)	(72,750)
Federal capital contributions	112,668	130,445
Other capital contributions	4,670	14,080
Net Capital Contributions	**1,781**	**71,775**
Change in Net Assets	**228,988**	**302,558**
Total Net Assets, Beginning of Year	**2,647,280**	**2,344,722**
Total Net Assets, End of Year	**$ 2,876,268**	**$ 2,647,280**

See Notes to Financial Statements.

STATEMENTS OF CASH FLOWS

(in thousands)	December 31 2007	December 31 2006
Cash Flows from Operating Activities		
Cash receipts from fares	$ 16,265	$ 24,969
Cash receipts from other operating revenue	4,066	3,328
Payments to suppliers	(18,876)	(26,789)
Payments to transportation service providers	(73,986)	(57,679)
Payments to employees for wages and benefits	(23,421)	(23,002)
Net Cash Used by Operating Activities	**(95,952)**	**(79,173)**
Cash Flows from Non-Capital Financing Activities		
Taxes received	351,962	328,959
Net Cash Provided by Non-Capital Financing Activities	**351,962**	**328,959**
Cash Flows from Capital and Related Financing Activities		
Capital contributions from grants	99,291	163,424
Proceeds on issuance of bonds	464,236	-
Proceeds on land sales	498	-
Proceeds for betterments and recoverable costs	4,499	2,643
Purchase of property, vehicles and equipment	(4,642)	(923)
Payments in respect of capital projects in progress	(657,518)	(651,701)
Payments to employees capitalized to capital projects in progress	(12,260)	(11,335)
Payments for bond interest, principal and promissory notes	(10,445)	(10,270)
Cash paid for interest	(37,510)	(37,690)
Payments to suppliers for non-operating expenses	(22,396)	(11,015)
Other	(322)	68
Net Cash Used by Capital and Related Financing Activities	**(176,569)**	**(556,799)**
Cash Flows from Investing Activities		
Purchases of investments	(349,972)	(322,461)
Proceeds from sales or maturities of investments	589,535	673,772
Investment income	23,209	31,354
Net Cash Provided by Investing Activities	**262,772**	**382,665**
Net Increase in Cash and Cash Equivalents	**342,213**	**75,652**
Cash and Cash Equivalents		
Beginning of year	304,627	228,975
End of Year	**$ 646,840**	**$ 304,627**
Cash and Cash Equivalents *(Note 3)*		
Unrestricted	$ 600,319	$ 215,768
Current restricted	2,432	2,665
Non-current restricted	44,089	86,194
	$ 646,840	**$ 304,627**

See Notes to Financial Statements.

STATEMENTS OF CASH FLOWS, continued

(in thousands)	December 31	
	2007	2006
Loss from Operations	**$ (125,406)**	**$ (119,611)**
Adjustments to Reconcile Loss from Operations to Net Cash Used by Operating Activities		
Depreciation, amortization and accretion	35,187	33,486
Loss on disposal of capital assets	309	3
Changes in Operating Assets and Liabilities		
(Increase) decrease in accounts receivable	(48)	42
(Increase) decrease in due from other governments	(5,224)	661
Decrease (increase) in materials, parts and supplies	425	(85)
Decrease in prepaid expenses	327	50
Increase (decrease) in accounts payable, accrued and other liabilities	2,596	(3,041)
Increase (decrease) in salaries, wages and benefits	210	(192)
(Decrease) increase in deferred pass fare receipts	(1,249)	1,872
(Decrease) increase in due to other governments	(3,079)	7,642
Net Cash Used by Operating Activities	**$ (95,952)**	**$ (79,173)**

(in thousands)	December 31	
	2007	2006
Supplemental Disclosures of Non-Cash Operating, Investing and Financing Activities		
Capital contributions to other governments	$ (115,557)	$ (72,750)
Capital contributions from Land Bank	700	3,275
Accounts payable in construction in progress	136,149	116,271
Interest income from investments held to pay capital leases, net	844	842
Interest expense on capital leases	(844)	(842)
Decrease in fair value of investments	(585)	(3,653)

See Notes to Financial Statements.

NOTES TO FINANCIAL STATEMENTS

YEARS ENDED DECEMBER 31, 2007 AND 2006

1. ORGANIZATION AND REPORTING ENTITY

As provided under the Revised Code of Washington ("RCW") Chapter 81.112 applicable to a regional transit authority, the Central Puget Sound Regional Transit Authority, a public corporation acting under the service name of Sound Transit, was established in 1993. Sound Transit was formed to implement a high-capacity transportation system throughout parts of King, Pierce, and Snohomish counties in the State of Washington through the design, construction, and implementation of a commuter rail ("Sounder"), light rail ("Link") and regional express bus system ("ST Express").

Reporting Entity—Sound Transit is a special purpose government supported primarily through sales tax, motor vehicle excise tax and rental car tax in Sound Transit's operating jurisdiction. In addition, Sound Transit receives capital funding from federal, state and local agencies.

Sound Transit is governed by an 18-member board, seventeen of whom are appointed by the respective member county executives and confirmed by the council of each member county. Membership is based on the population from the portion of each county that lies within Sound Transit's service area. Representation on the board shall include an elected official representing the largest city in each county and ensures proportional representation from other cities and from unincorporated areas of each county. The final board position is held by the Secretary of Transportation, Washington State Department of Transportation.

Accounting principles generally accepted in the United States of America require that the reporting entity include the primary government, all organizations for which the primary government is financially accountable and other organizations that, by the nature and significance of their relationship with the primary government, would cause the financial statements to be incomplete or misleading if excluded. Based on these criteria, Sound Transit is considered a primary government and does not have any component unit relationships. Conversely, Sound Transit is not considered a component unit of any primary government.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The following summary of significant accounting policies is presented to assist the reader in interpreting the financial statements and should be considered an integral part of the financial statements.

Basis of Accounting—The accounts are maintained and financial statements prepared using the economic resources measurement focus and accrual basis of accounting in accordance with accounting principles generally accepted in the United States of America and methods prescribed by the State Auditor under the authority of RCW Chapter 43.09 for proprietary funds. The Governmental Accounting Standards Board ("GASB") is the accepted standard-setting body for establishing governmental accounting and financial reporting principles. All applicable GASB pronouncements, as well as all Financial Accounting Standards Board ("FASB") statements and interpretations have been applied, except for those FASB statements and interpretations that contradict GASB pronouncements.

Tax revenues include taxes on retail sales of goods and services, rental car revenue and a motor vehicle excise tax. These taxes are levied within the district at a rate of 0.4% for sales and use, 0.8% on rental car revenue and 0.3% for motor vehicle excise. These taxes are collected on Sound Transit's behalf by the Department of Revenue and the Department of Licensing of the State of Washington and are recorded in

the period when the underlying transaction occurs on which the tax is imposed. Operating revenues consist primarily of passenger fares, which are recognized in the period in which services are provided and are earned, and expenses are recognized in the period in which they are incurred. All assets and liabilities associated with the operation of Sound Transit are included in the Balance Sheets. Depreciation of capital assets and amortization of deferred revenue is recognized in the Statements of Revenues, Expenses and Changes in Net Assets.

Capital Assets—Capital assets are stated at cost, except for donated capital assets, which are stated at the fair value on the date of donation. Expenditures for additions and improvements with a value in excess of $5,000 and a useful life of more than one year are capitalized. Expenditures for maintenance, repairs and minor improvements are charged to operations as incurred. Depreciation of capital assets is recorded using the straight-line method over the estimated useful lives of the assets and leasehold improvements over the shorter of the life of the asset or length of the related agreement as follows:

	Estimated Useful Life
Rail access costs	37–40 years
Buildings	8–30 years
Transit facilities, rail, and equipment	4–70 years
Park-and-ride lots and shelters	10 years
Revenue vehicles—Cab cars and coach cars	40 years
Revenue vehicles—Locomotives	29 years
Revenue vehicles—Light rail	25 years
Revenue vehicles—Buses	7–12 years
Furniture and equipment	3–7 years
Administrative vehicles and leasehold improvements	5 years

On an annual basis, Sound Transit evaluates whether events or circumstances have occurred affecting capital assets that are other than temporary in nature and which could result in an impairment of those assets. Impairment is considered to have occurred if there is a decline in the service utility that is large in magnitude and the event or circumstance is outside the normal life cycle of the asset. Impairment losses on assets that will no longer be used are measured based on the lower of carrying value or fair value of the affected asset. Impairment losses on assets that will continue to be used are measured using the best method that reflects the diminished service utility of the related asset.

All costs directly attributable to capital projects, as well as certain indirect costs that are allocated to the projects based on various applicable factors supporting the overhead rates used, are capitalized. Capital projects in progress balances include costs incurred for transportation projects not yet in service and are segregated between assets in which Sound Transit maintains a continuing ownership interest and capital assets that will be transferred to other governments upon completion.

Rail access costs reflect the cost of acquiring rights from BNSF for the Tacoma-to-Seattle and Everett-to-Seattle segments. In the Tacoma-to-Seattle corridor these rights were acquired in an amount equal to the funding of necessary track and signal improvements on the line and in the Everett-to-Seattle corridor through the direct acquisition of easements. In addition, these costs include Sound Transit’s direct and indirect costs related to the planning and design, environmental management and permitting. The rail access rights for additional round trip service are acquired incrementally, as certain requirements are met under their respective agreements, and accordingly ongoing costs are capitalized to the depreciable asset on a quarterly basis.

Interest costs on funds borrowed through tax-exempt debt to finance the construction or acquisition of certain capital assets are capitalized during the period of construction or acquisition and are depreciated over the life of the related assets once placed into service.

Capital Contributions to Other Governments—Pursuant to capital improvement agreements, Sound Transit has provided funding to or constructed assets for various governments or their wholly owned subsidiaries for transit-related capital improvements. For assets constructed for other governments, these costs are capitalized and included in capital projects in progress until the asset is substantially completed and accepted, at which time it is charged to contributions to other governments.

Cash and Cash Equivalents—Cash and cash equivalents consist of cash on hand, demand deposits and short-term investments with maturities of three months or less when purchased, investments in the Local Government Investment Pool and the King County Investment Pool, which are managed by the Washington State Treasurer's Office and the King County Finance Division, respectively.

Compensated Absences—Vacation leave that has been earned but not paid has been accrued in the accompanying financial statements. Similarly, sick leave is accrued as the benefits are earned but only to the extent that Sound Transit will compensate the employees through cash payments conditional on the employee's termination, retirement or death. Vacation pay, which may be accumulated up to 50 days, is payable upon termination, retirement or death. Sick leave is payable at the rate of 50% of accrued hours upon resignation, retirement or death for employees hired before January 1, 2004, and 25% thereafter and is limited to 120 days for termination other than for retirement or death.

Environmental Reserves—Environmental conditions are evaluated at the time of purchase of land and are factored into the purchase price. Upon purchase, or at the time of discovery, the estimated cost of remediation is accrued and subsequently relieved as remediation occurs or if there is a reduction in the estimated cost to remediate. Revisions to those estimates are accounted for as a project cost or expensed depending on the nature of the remediation required.

Investment Valuation—Investments are generally stated at fair value based on quoted market prices, as available. The restricted investment held for the 2005A Bond Reserve is not available for sale and accordingly is carried at cost.

Operating and Contingency Fund—In accordance with Board policy, Sound Transit maintains a cash reserve based on two months of average annual operating expenses, to be used in the event of budget shortfalls. As this is an internally restricted cash balance, this balance is included in cash and cash equivalents.

Capital Replacement Fund—In 2007 Sound Transit's Board adopted by resolution a capital replacement reserve to be utilized for major maintenance and repair of Sound Transit's capital assets consistent with the agency's long term financial plan and methodologies outlined by the Federal Transit Administration. A separate investment portfolio was created with interest earnings reinvested within the reserve. As this is an internally restricted investment balance, this balance is included in unrestricted investments.

Parts, Materials and Supplies—Parts, materials and supplies are recorded as inventory at the lower of purchased cost or net realizable value. These assets are reviewed periodically for slow-moving and obsolete items, and any impairment in value is reflected as a charge to operations.

Reclassifications—Certain reclassifications have been made to the 2006 Financial Statements to conform to the current year's presentation.

Restricted Assets—Restricted assets are assets set aside to meet externally imposed legal and contractual obligations. Restricted assets are used in accordance with their requirements, and where both restricted and

unrestricted resources are available for use, restricted resources are used first and then unrestricted resources as they are needed.

Revenue and Expense Classification—Sound Transit distinguishes operating revenues and expenses from non-operating items in the preparation of its financial statements. Operating revenues and expenses generally result from providing passenger services in connection with Sound Transit's principal ongoing operations. The principal operating revenues are passenger fares. Sound Transit's operating expenses include labor, materials, services, claims, purchased transportation and other expenses related to the delivery of passenger transportation within the Central Puget Sound region. All revenues and expenses not meeting this definition are reported as non-operating revenues and expenses.

Subarea Accounting—Sound Transit allocates revenue and expenses, and certain assets and liabilities to each of the included jurisdictions in accordance with *Sound Move* and established policies. Presentation of such allocation is not a required disclosure under accounting principles generally accepted in the United States of America. Accordingly, a separate agreed upon procedures report and Schedule of Subarea Equity is issued.

Use of Estimates—The preparation of the financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Actual results could differ from those estimates.

3. CASH, CASH EQUIVALENTS, INVESTMENTS AND RESTRICTED ASSETS

Sound Transit's bank deposits are covered by the Federal Deposit Insurance Corporation ("FDIC") or by collateral held in a multiple financial institution collateral pool administered by the Washington Public Deposit Protection Commission ("PDPC"). All deposits not covered by the FDIC are covered by the PDPC. Cash held in the Local Government Investment Pool and the King County Investment Pool are managed by the Washington State Treasurer's Office and the King County Finance Division, respectively. These pools represent an interest in a group of securities and have no specific security subject to custodial risk.

All surplus cash is invested in accordance with an investment policy approved by Sound Transit's Board and certified by the Municipal Treasurer's Association. Qualifying investments under this policy include obligations of the United States government, Treasury and Agency securities, bankers' acceptances, certificates of deposit, commercial paper and repurchase agreements. Sound Transit's investment policy addresses common deposit and investment risks as described below.

Interest Rate Risk—Interest rate risk is the risk that changes in interest rates will adversely affect the fair value of an investment. Sound Transit manages its exposure to fair value losses by matching its investments to cash flow requirements and by comparing the modified duration of fixed income securities in its investment portfolios to established benchmarks. Deviation from the established benchmark within 25% is considered acceptable by the Agency. Modified duration estimates the sensitivity of a bond's price to interest rate changes. At December 31, 2007, benchmark duration for Sound Transit's unrestricted portfolio was 0.57 and its restricted portfolio was 0.44. A benchmark had not been established for the Capital Replacement Reserve, which was authorized in December 2007. Actual modified duration by investment type is presented in the table on the following page.

Concentration of Credit Risk—Concentration of credit risk is the risk associated with a lack of diversification or having too much invested in a few individual issues. The investment policy sets forth maximum concentration guidelines whereby no single Agency exceeds 50% of the overall portfolio, or 10% for certificates of deposit, bankers' acceptances, repurchase agreements, general obligation bonds and

A1/P1 commercial paper. Treasury securities may comprise up to 100% of the portfolio, as well as participation in the Washington State Treasurer's Local Government Investment Pool. Agency Securities (combined) may comprise up to 75% of the portfolio. Participation in the King County Investment Pool is limited to 50% of the portfolio. The table on the following page provides the percentage invested in each type of investment as of December 31, 2007.

Credit Risk—Credit risk is the chance that an issuer will fail to pay principal or interest in a timely manner, or that negative perceptions of the issuer's ability to make these payments will cause the price of the investment to decline. All Agency securities in our portfolios are rated AAA, and the Certificate of Deposit is covered by the PDPC. The King County Investment Pool rating of AAAf has been temporarily suspended due to asset backed commercial paper in their portfolio, which is in default. The Washington State Treasurer's Local Government Investment Pool is a 2a7-like pool and is unrated.

During the year Sound Transit reduced the funds on deposit with the County Pool, and has recorded an estimated loss in the amount of $209,000 which is the expected pro-rata share of the loss based on independent market valuations obtained by the County.

Custodial Credit Risk—Custodial credit risk is the risk that, in the event of the failure of the counterparty, Sound Transit would not be able to recover the value of its investment or collateral securities that are in the possession of an outside party. All investments purchased by Sound Transit are held and registered in Sound Transit's name in the Trust Department or safekeeping department of a financial institution, as established by a written third party safekeeping agreement between Sound Transit and the financial institution.

Cash, cash equivalents, investments and restricted assets are as follows (modified duration in years):

(in thousands)	2007 Fair Value	2007 Modified Duration	2007 % of Portfolio	2006 Fair Value	2006 Modified Duration	2006 % of Portfolio
Deposits and Investments						
US agency securities:						
Federal Farm Credit Bank	$ 7,746	1.390	9.68%	$ 62,694	0.581	16.52%
Federal Home Loan Bank	23,453	1.022	29.30%	110,049	0.444	29.00%
Federal Home Loan Mortgage Corporation	9,452	0.372	11.81%	80,192	0.527	21.13%
Federal National Mortgage Association	11,886	0.449	14.85%	10,079	0.213	2.66%
US treasury securities	-	0.000	0.00%	64,581	0.524	17.02%
Certificate of deposit	8,000	0.160	10.00%	8,000	1.100	2.11%
FDIC or PDPC insured bank deposits	19,502	0.000	24.37%	43,890	0.000	11.57%
	80,038	0.561	100.00%	379,485	0.454	100.00%
Cash and Cash Equivalents						
Investment Pools:						
King County	181	0.550		26,775	0.400	
Washington State Local Government	618,794			225,449		
US discount note:						
Federal Home Loan Bank	280	0.010		-	-	
Federal Home Loan Mortgage Corporation	-	-		410	0.011	
Cash on hand	83			103		
	619,338			252,737		
Other Restricted Assets						
Deductible liability protection policy	4,219			5,254		
2005A Bond Reserve - FHLB Discount Note	39,892	0.330		-		
Interest receivable on restricted investments	188			496		
	44,299			5,750		
Total Cash, Cash Equivalents, Investments and other Restricted Assets	$ 743,675			$ 637,972		

(in thousands)	December 31	
	2007	**2006**
Balance Sheet Classifications		
Cash and cash equivalents	$ 600,319	$ 215,768
Current restricted assets:		
Cash equivalents	$ 2,432	2,665
Deductible liability protection policy	$ 4,219	5,254
	6,651	7,919
Investments	$ 23,165	280,095
Non-current restricted assets:		
Cash Equivalents	$ 44,089	86,194
Investments	$ 69,263	47,500
Other assets	$ 188	496
	113,540	134,190
	$ 743,675	**$ 637,972**

4. RECEIVABLES

Receivables consist of the following:

(in thousands)	December 31	
	2007	**2006**
Taxes receivable	$ 57,384	$ 54,149
Grants receivable	22,703	5,357
Accounts receivable, net	139	595
Due from Other Governments	14,903	15,614
Interest receivable	1,181	3,514
Current portion supplemental mitigation advances	-	2
	$ 96,310	**$ 79,231**

Amounts due from other governments include amounts due under the Puget Pass regional fare program, amounts reimbursable under interlocal agreements for operating expenses or capital contributions for transit facilities, and betterments. Payment terms are generally defined in the various agreements with other governments and range from 21 days to 60 days. Where payment terms are not defined by agreement, they are due in accordance with the terms specified in the invoice, which is generally 30 days.

5. CAPITAL ASSETS

Capital assets are summarized as follows:

(in thousands)	December 31 2005	Transfers In and Additions	Transfers Out and Retirements	December 31 2006	Transfers In and Additions	Transfers Out and Retirements	December 31 2007
Non-Depreciable Assets							
Land	$ 269,136	$ 23,910	$ (2,170)	$ 290,876	$39,604	$ (3,896)	$ 326,584
Permanent easements	160,967	55,718	-	216,685	50,491	-	267,176
Capital Projects in Progress							
Sound Transit	1,071,126	645,278	(157,842)	1,558,562	671,173	(186,572)	2,043,163
Other Governments	119,852	61,953	(78,027)	103,778	66,399	(116,066)	54,111
Total Non-Depreciable Assets	**1,621,081**	**786,859**	**(238,039)**	**2,169,901**	**827,667**	**(306,534)**	**2,691,034**
Depreciable Assets							
Transit facilities, rail and heavy equipment	223,807	41,838	-	265,645	67,620	(575)	332,690
Rail access rights	270,898	34,047	-	304,945	25,181	-	330,126
Buildings and leasehold improvements	23,168	-	-	23,168	10	-	23,178
Revenue vehicles	231,139	578	-	231,717	3,881	-	235,598
Furniture, equipment and vehicles	13,975	895	(23)	14,847	1,558	(479)	15,926
Equipment under capital lease	863	38	-	901	170	(131)	940
Total Depreciable Assets	**763,850**	**77,396**	**(23)**	**841,223**	**98,420**	**(1,185)**	**938,458**
Accumulated Depreciation							
Transit facilities and heavy equipment	(34,244)	(11,764)	-	(46,008)	(12,480)	28	(58,460)
Rail access rights	(8,282)	(7,765)	-	(16,047)	(8,942)	-	(24,989)
Buildings and leasehold improvements	(5,785)	(770)	-	(6,555)	(776)	-	(7,331)
Revenue vehicles	(48,309)	(11,356)	-	(59,665)	(11,400)	-	(71,065)
Furniture, equipment and vehicles	(10,550)	(1,533)	20	(12,063)	(1,271)	216	(13,118)
Equipment under capital lease	(191)	(198)	-	(389)	(222)	73	(538)
Total Accumulated Depreciation	**(107,361)**	**(33,386)**	**20**	**(140,727)**	**(35,091)**	**317**	**(175,501)**
Depreciable Assets, Net	**656,489**	**44,010**	**(3)**	**700,496**	**63,329**	**(868)**	**762,957**
Total Capital Assets, Net	**$ 2,277,570**	**$ 830,869**	**$ (238,042)**	**$ 2,870,397**	**$ 890,996**	**$ (307,402)**	**$ 3,453,991**

During 2007, Sound Transit capitalized $37.3 million of interest costs, ($36.6 million in 2006), representing all of the interest, net of premium, discounts and bond issue costs, incurred on its bonds outstanding (see Note 8).

6. CAPITAL AND OPERATING LEASES

Capital lease obligations are comprised of the following:

(in thousands)	2007	2006
Lease/leaseback	$ 60,770	$ 59,925
Copier leases	426	536
	61,196	60,461
Less current portion	(228)	(191)
	$ 60,968	**$ 60,270**

Notes to Financial Statements, continued

Lease/Leaseback—On May 31, 2001, Sound Transit entered into a transaction to lease 22 rail passenger cab and coach cars and 5 locomotives (the "headlease") to an investor and simultaneously subleased the vehicles back (the "sublease"). Under these transactions, Sound Transit maintains the right to continued use and control of the assets through the end of the leases and is required to insure and maintain the assets. The headlease and sublease have been recorded as capital leases for accounting purposes.

The vehicles had a fair market value of $61.3 million with a book value of $37.7 million at closing. Sound Transit received a prepayment equivalent to the net present value of the headlease obligations totaling $61.3 million. From those proceeds, $50.4 million was deposited with AIG-FP Special Finance Ltd. to partially meet Sound Transit's obligations under the sublease payments. In addition, $5.7 million was deposited with AIG Matched Funding Corp. and invested in securities issued or guaranteed by the United States government to meet the remaining obligations under the sublease. The remaining $4.9 million (net of closing costs of $363 thousand) was retained by Sound Transit and recorded as non-operating revenues in the year ended December 31, 2001.

The net present value of the future sublease payments has been recorded as a long-term capital lease obligation. The underlying investments have been structured to meet all future obligations under the sublease when due, and as such, have been recorded to equal the sublease obligations on the accompanying balance sheet.

Net changes in the sublease are shown in the following table:

(in thousands)	**2007**	**2006**
Net sublease, January 1	$ 59,925	$ 59,083
Accrued interest	4,485	4,422
Less payment	(3,640)	(3,580)
Net Sublease, December 31	**$ 60,770**	**$ 59,925**

Amtrak Lease/Sublease—In September 2000, Sound Transit entered into a 40-year agreement to lease its locomotives, passenger coaches and cab cars ("rolling stock") to the National Railroad Passenger Corporation ("Amtrak") for $1. Under the agreement Amtrak is obligated to repair, maintain and service the rolling stock at Amtrak's maintenance facility in return for payment by Sound Transit. By separate agreement, Sound Transit assigned to Amtrak its commuter rail operating agreement, which it had entered into with the BNSF Railway Company ("BNSF") in May 2000 to provide commuter rail service. In order to give BNSF possession and use of the rolling stock for purposes of providing commuter rail service on Amtrak's behalf for Sound Transit, Amtrak entered into a 40-year sublease of the rolling stock to BNSF for a nominal rental payment of $1.

Under the legal structure of these transactions and pursuant to a Department of Revenue ruling, the equipment is exempted from Washington State sales and use taxes, and Sound Transit and Amtrak have agreed by a Memorandum of Understanding to use funds that would otherwise be payable for projects that mutually benefit Pacific Northwest intercity rail passenger service. Sound Transit maintains title and continuing control of the assets through the end of the lease, upon which the assets will be returned to Sound Transit.

Operating Rentals—Sound Transit leases office space, parking, land and equipment storage at various locations including space adjacent to Union Station, Auburn, Bellevue, Issaquah, Mercer Island, Puyallup,

Seattle, Tacoma and Tukwila under non-cancelable operating leases in excess of one year with lease terms expiring in 2007 through 2011.

Minimum lease payments through 2011 are as follows:

Operating Rentals, commitments next 5 years:

(in thousands)	
2007	$ 2,157
2008	1,442
2009	816
2010	232
2011	222
	$ 4,869

Total rental costs for 2007, which include non-cancelable leases as well as other month-to-month rentals, were $2.4 million of which $468 thousand was for capital projects in progress. Total rental costs for 2006 were $2.2 million, of which $529 thousand was for capital projects in progress.

7. ACCOUNTS PAYABLE AND ACCRUED LIABILITIES

Accounts payable and accrued liabilities consist of the following:

(in thousands)	**2007**	**2006**
Accounts payable	$ 17,465	$ 31,164
Accrued liabilities	52,769	22,422
Due to other governments	44,268	45,346
Accrued salaries, wages and benefits	1,623	1,550
Retainage payable	311	62
	$ 116,436	**$ 100,544**

8. LONG-TERM DEBT

Long-term debt consists of the following:

(in thousands)	2007 Beginning Balance	Additions	Reductions	2007 Ending Balance	Amounts Due within One Year
Bonds payable:					
Series 1999 Bonds, at par	$ 345,730	-	$ (4,445)	$ 341,285	$ 4,620
Series 2005A Bonds, at par	422,815	-	-	422,815	-
Series 2007A Bonds, at par	-	450,000	-	450,000	14,555
	768,545	450,000	(4,445)	1,214,100	19,175
Plus unamortized premium	22,460	17,009	(1,761)	37,708	
Less unamortized discount	(6,732)	-	384	(6,348)	
Total bonds payable	784,273	467,009	(5,822)	1,245,460	19,175
Promissory notes:					
Lakeview South Line	6,000	-	(6,000)	-	-
Plus (minus) imputed interest	(199)	-	199	-	-
Total promissory notes payable	5,801	-	(5,801)	-	-
Total Long-Term Debt	**$ 790,074**	**$ 467,009**	**$ (11,623)**	**$ 1,245,460**	**$ 19,175**

(in thousands)	2006 Beginning Balance	Additions	Reductions	2006 Ending Balance	Amounts Due within One Year
Bonds payable:					
Series 1999 Bonds, at par	$ 350,000	-	$ (4,270)	$ 345,730	$ 4,445
Series 2005A Bonds, at par	422,815		-	422,815	-
	772,815	-	(4,270)	768,545	4,445
Plus unamortized premium	24,221	-	(1,761)	22,460	
Less unamortized discount	(7,117)	-	385	(6,732)	
Total bonds payable	789,919	-	(5,646)	784,273	4,445
Promissory notes:					
Lakeview North Line, replacement	3,000	-	(3,000)	-	-
Lakeview South Line	9,000	-	(3,000)	6,000	6,000
	12,000	-	(6,000)	6,000	6,000
Plus (minus) imputed interest	(605)	-	406	(199)	(199)
Total promissory notes payable	11,395	-	(5,594)	5,801	5,801
Total Long-Term Debt	**$ 801,314**	-	**$ (11,240)**	**$ 790,074**	**$ 10,246**

Sales Tax and Motor Vehicle Excise Tax Bonds, Series 1999—On January 6, 1999, Sound Transit issued tax-exempt Sales Tax and Motor Vehicle Excise Tax Bonds, Series 1999 dated December 1, 1998, in the amount of $350 million. The bonds are special limited obligations of Sound Transit payable from and secured solely by a pledge of Sound Transit’s sales and use tax, motor vehicle excise tax and rental car tax imposed at the rates of 0.4%, 0.3%, and 0.8% respectively and are considered senior to the Series 2005A and 2007A subsequently issued.

Sales Tax Bonds, Series 2005A —On March 31, 2005, Sound Transit issued tax-exempt Sales Tax Bonds, Series 2005A dated March 31, 2005, in the amount of $422.8 million. These bonds were issued on a subordinate basis to the prior bonds issued. These bonds are special limited obligations of Sound Transit payable from and secured solely by a pledge of Sound Transit's sales and use tax and rental car tax.

Sales Tax Bonds, Series 2007A — On December 18, 2007, Sound Transit issued tax-exempt Sales Tax Bonds, Series 2007A dated December 18, 2007, in the amount of $450.0 million. These bonds were issued on a subordinate basis to prior bonds issued. These bonds are special limited obligations of Sound Transit payable from and secured solely by a pledge of Sound Transit's sales and use tax and rental car tax.

Sound Transit is required to maintain certain minimum deposits as defined in the respective bond resolution for each bond issue to meet debt service requirements. In addition, for the Series 2005A Bonds, the Agency established a $39.5 million reserve, consistent with the Parity Bond Resolution, which is invested in a Forward Purchase and Sale Agreement with a guaranteed yield of 5.18% for the life of the bond reserve. Proceeds from all bond issues have been used for the Agency's capital projects.

The following tables set forward average and effective coupon rates, rating agency information, principal payment commencement, fair value, amounts currently restricted for debt service and debt requirements to maturity.

		Average Rate		**Ratings**		**Principal**
	Issue Date	**Coupon**	**Effective**	**Moody's [1]**	**S&P [2]**	**Payment Commencement**
Series 1999	Dec 1, 1998	4.88	5.03	Aa2*	AAA	Feb 1, 2006
Series 2005A	March 31, 2005	4.95	4.60	Aa3	AAA**	Nov 1, 2011
Series 2007A	Dec 18, 2007	4.99	4.76	Aa3	AAA**	Nov 1, 2008

	December 31			
(in millions)	**Fair Value [3]**		**Cash Restricted For Debt Service**	
	2007	2006	2007	2006
Series 1999	354.70	361.90	11.60	11.50
Series 2005A	442.50	447.40	3.40	3.40
Series 2007A	466.70	-	0.81	-

* Upgraded in 2007 from Aa3
**Upgraded in 2007 from AA+

[1] Moody's Investor Services
[2] Standard and Poor's
[3] Estimated using quoted market prices.

Debt service requirements to maturity for bonds payable.

Year Ending December 31	Principal	(in thousands) Interest	Total
2008	19,175	56,766	75,941
2009	19,810	58,865	78,675
2010	8,065	57,862	65,927
2011	18,465	57,475	75,940
2012	19,195	56,744	75,939
2013-2017	117,405	268,669	386,074
2018-2022	202,390	229,914	432,304
2023-2027	259,165	172,670	431,835
2028-2032	281,150	108,859	390,009
2033-2036	269,280	34,481	303,761
	$ 1,214,100	**$ 1,102,305**	**$ 2,316,405**

Lakeview North and South Line Promissory Notes — On September 28, 2004, Sound Transit acquired a section of the Lakeview Subdivision between Lakewood and Nisqually, called the North Line, in exchange for a payment of $6 million and a $6 million promissory note payable to BNSF in September of 2006. In November 2004, a replacement note was agreed upon whereby if the south parcels were acquired (the "South Line") then $3 million of the note became due on September 28, 2005, with the balance of $3 million due and paid at maturity on September 28, 2006.

The South Line acquisition closed on October 3, 2005, resulting in the change in the terms of the North Line note as described. In addition, Sound Transit paid $3 million, assumed a promissory note payable of $9 million to BNSF with a payment due and paid of $3 million on September 28, 2006, and $6 million on September 28, 2007. These promissory notes were non-interest bearing and, in accordance with generally accepted accounting principles, were discounted to reflect the imputed interest cost to the Agency.

9. OTHER LONG-TERM OBLIGATIONS

Other long-term obligations include provisions for asset retirement obligations, uninsured losses related to the agency's risk management program and employee compensated absences as follows:

(in thousands)	2007 Beginning Balance	Additions and accretion	Reductions	2007 Ending Balance	Amounts Due within One Year
Asset retirement obligations					
Sounder station platforms	$ 955	$ (43)	$ -	$ 912	$ -
Tacoma Link surface rail	1,607	(275)	-	1,332	-
Total asset retirement obligations	2,562	(318)	-	2,244	-
Uninsured Losses					
Owner Controlled Insurance Program	2,508	5,040	(1,251)	6,297	1,269
Transit operations	414	721	(682)	453	74
Total uninsured losses	2,922	5,761	(1,933)	6,750	1,343
Compensated absences	2,855	3,370	(3,106)	3,119	989
Total other long-term obligations	**$ 8,339**	**$ 8,813**	**$ (5,039)**	**$ 12,113**	**$ 2,332**

(in thousands)	2006 Beginning Balance	Additions and accretion	Reductions	2006 Ending Balance	Amounts Due within One Year
Asset retirement obligations					
Sounder station platforms	$ 823	$ 132	$ -	$ 955	$ -
Tacoma Link surface rail	1,192	415	-	1,607	-
Total asset retirement obligations	2,015	547	-	2,562	-
Uninsured Losses					
Owner Controlled Insurance Program	2,283	1,725	(1,500)	2,508	518
Transit operations	322	92	-	414	81
Total uninsured losses	2,605	1,817	(1,500)	2,922	599
Compensated absences	3,007	3,254	(3,406)	2,855	973
Total other long-term obligations	**$ 7,627**	**$ 5,618**	**$ (4,906)**	**$ 8,339**	**$ 1,572**

Asset Retirement Obligations—In the course of entering into agreements with other governments and rail providers to construct the Agency's capital assets used in providing transportation services, certain of those agreements contain clauses that impose a legal burden on the Agency to remove all or a portion of those constructed assets at the termination of those agreements. FASB 143 and FASB Interpretation 47, require that these costs and related obligations be recognized where they exist.

Risk Management—In the ordinary course of its operations, Sound Transit is exposed to various risks of loss related to torts; theft of, damage to and destruction of assets; errors and omissions; injuries to persons; and natural disasters. Sound Transit has established a comprehensive risk management program, utilizing the purchase of commercial insurance that has in force first-level coverage for property, liability, employment practices and crime and fidelity to provide protections from these exposures. Such coverage includes self-insured, per claim retention insignificant to Sound Transit's risk of loss. There have been no changes to the policy since inception and no settlements have exceeded coverage under the plan.

Sound Transit also established an Owner-Controlled Insurance Program ("OCIP") for all general liability claims by third-party injuries and/or property damage related to project construction activities carried out by third-party contractors. This commercially procured insurance program includes a self-insured retention level of $500 thousand per claim. This program originally covered construction projects from January 1, 2001, through December 31, 2006, and all premium payments under the policies had been prepaid. A policy extension was negotiated through December 31, 2009, with the exception of the professional liability and contractor's pollution policy, which was extended to December 31, 2016 with an additional 3-year reporting period extending to December 31, 2019.

Sound Transit has also entered into a deductible liability protection policy to supplement the self-insured retention portion of the OCIP. Under this policy the probable maximum claims exposure, estimated at $6.5 million, was deposited with the insurer in an interest-bearing loss fund account, of which a balance of $4.2 million is remaining at December 31, 2007 (see Note 3).

Claim amounts estimated to be paid within the next year are included in other current liabilities.

Compensated Balances—Amounts estimated to be paid within the next year are included in accrued salaries, wages and benefits.

10. RESTRICTED NET ASSETS

Restricted net assets consist of the following:

(in thousands)	2007	2006
Contractual arrangements	$ 58,063	$ 80,098
Debt service, net of related obligations	44,512	44,095
Deductible liability protection policy	4,219	5,254
State appropriation	2,152	2,152
	$ 108,946	**$ 131,599**

11. EMPLOYEE BENEFITS

Sound Transit provides a defined contribution money purchase plan and trust (“401(a) Plan”) to its employees. Prior to December 31, 1999, employees had a choice of participating in either the 401(a) Plan or in the Washington Public Employees’ Retirement System (“PERS”). In 1999, the Washington State Legislature amended the laws governing PERS requiring employers either to terminate their participation in PERS or permit all new employees to participate in PERS regardless of their simultaneous participation in a 401(a) plan. Effective December 31, 1999, Sound Transit terminated its status as a PERS employer with regard to all employees hired after that date. Individuals who were active members at that date were eligible to continue their membership in PERS for the duration of their continuous employment with Sound Transit. At December 31, 2007, 2006 and 2005, there was one remaining employee participating in PERS.

A summary of the 401(a) Plan is as follows:

401(a) Plan—A defined contribution money purchase plan and trust was established for the Agency in 1994 with the adoption of Board Resolution No. 32. This was amended by Resolution No. 100 in 1997 to recognize the contribution made to Sound Transit by its employees. The ICMA Retirement Corporation administers the Central Puget Sound Regional Transit Authority Pension Plan and serves as the plan’s trustee. This plan is a fixed employer system, and membership in the system includes all full-time Sound Transit employees and elected officials. The vesting schedule of the plan is 20% immediately upon employment, 40% after one year of service, 60% after two years, 80% after three years and 100% after four years. Employees are responsible for directing the investment of their contributions and Sound Transit’s contributions.

Any eligible employee who was employed on the effective date of this plan was eligible to participate in the plan. Any other eligible employee shall be eligible to participate on the first day of employment.

Sound Transit's actual contribution rates, which were the required contribution rates, are expressed as a percentage of covered payrolls. The amount of covered payroll during 2007 and 2006 was $26.8 and $25.9 million respectively, and total payroll was 27.2 million and 26.3 million respectively. The required contribution rates expressed as a percentage of covered payroll and required Sound Transit contributions during 2007, 2006, and 2005 are as follows:

	Contribution Rate			Contributions *(in thousands)*		
	2007	**2006**	**2005**	**2007**	**2006**	**2005**
Employer	12%	12%	12%	$3,213	$3,111	$3,038
Employee	10%	10%	10%	2,678	2,592	2,532
Total	**22%**	**22%**	**22%**	**$5,891**	**$5,703**	**$5,570**

12. COMMITMENTS AND CONTINGENCIES

Operations and Maintenance Agreements—Sound Transit entered into 40-year agreements in May of 2000 with BNSF and Amtrak for the operations and maintenance of its Sounder commuter rail service. Under the BNSF agreement, Sound Transit pays in accordance with an hourly rate schedule per train mile that is based on the number of trains per day. Under the Amtrak agreement, Sound Transit pays a flat monthly fixed price dependent upon the number of one-way trips. See related agreements described in Note 6: *Amtrak Lease/Sublease*.

On June 24, 2002, Sound Transit entered into an agreement with King County to share Downtown Seattle Transit Tunnel maintenance and operation costs. Sound Transit's obligations include transfer of betterments, reimbursement of costs, and payment of a share of county debt service owed for the original tunnel construction. Sound Transit is also committed under this agreement to share costs for future capital repairs or replacements as they arise. Compensation is calculated as reimbursement of certain county costs based on fixed percentages. The DSTT agreement remains in effect indefinitely, contingent upon King County and Sound Transit entering into a Light Rail operating agreement.

On June 24, 2003, Sound Transit entered into a Central Link Light Rail system operation and maintenance agreement with King County. The agreement term extends five years beyond the commencement of passenger revenue service. Compensation for this service is based on reimbursement for county expenses based on a fixed amount for a baseline level of service, with additional costs billed for service changes directed by Sound Transit.

In 2004, Sound Transit entered into five-year agreements that expire September 2009 with Community Transit, King County Department of Transportation and Pierce Transit ("purchased transportation providers") to operate its ST Express public transportation service within Sound Transit's service area. Service is compensated based upon a fixed fee agreed to annually, with certain items subject to variable pricing, such as fuel and special services.

Agreements with BNSF for Sounder Commuter Rail Service in the Everett-to-Seattle and Lakewood-to-Tacoma Corridors—On December 18, 2003, Sound Transit entered into a number of agreements with BNSF for, among other things, the purchase of four perpetual easements for commuter rail service between Everett and Seattle, the purchase of railroad right-of-way between Nisqually and Tacoma for

service and station improvements, terms for joint use of the railroad right-of-way and the purchase of operation services in each corridor.

The acquisition of the easements and property occurred over a four-year payment period. The first easement in the Everett-to-Seattle corridor closed in December 2003, and the second easement closed in December 2004, each in exchange for a payment of $79.0 million. The third easement closed in December 2006 and the fourth and final easement closed in December 2007, each in exchange for a payment of $50 million. Each easement allows the addition by Sound Transit of one round trip commuter train service.

The Joint-Use Agreement for the Everett-to-Seattle corridor provides the mechanism for determining the cost to Sound Transit for the maintenance-of-way and rehabilitation activities on the corridor.

The Joint-Use Agreement for the Lakewood-to-Tacoma corridor sets forth the cost to BNSF for the maintenance-of-way and rehabilitation activities on the corridor and Sound Transit's and BNSF's responsibilities during the interim period before Sound Transit starts operating on each portion of the corridor. However, as Sound Transit incrementally commences construction of the line, Sound Transit will be responsible for maintenance activities on those sections.

The Everett-to-Seattle Commuter Rail Service Agreement set forth the terms for the actual operation of the commuter trains by BNSF and the compensation paid to BNSF for train crews, maintenance-of-way and other expenses incurred in the operation of the Sounder service between Seattle and Everett. The compensation is structured to provide flat rates for maintenance and crews with inflation adjusters plus performance incentives. The term of the agreement is for 12 years with an option of five additional years that must be agreed to by both parties, for a maximum term of 17 years. In addition, a first amendment was executed to the existing long-term agreement for commuter service from Seattle to Tacoma, covering service for the Lakewood-to-Tacoma corridor, provided Sound Transit eventually operates in the corridor.

Governmental Agreements— In its ordinary course of planning design and construction of its projects, Sound Transit enters into agreements with other governments. These agreements establish the working relationships with the other governmental entities and may obligate Sound Transit to pay for services over the lifecycle of a construction project, and often include provisions to transfer property or property rights upon completion of construction. Significant governmental agreements include:

> *City of Seattle Construction Services Agreement*: Entered into on November 13, 2003, this agreement covers areas including, quality assurance & inspections, emergency services, traffic signal design, and utility work by city crews. The agreement also commits Sound Transit to accomplish certain betterments and utility upgrades, which are to be reimbursed by the city. All commitments under this agreement are anticipated to be completed during 2008.
>
> *Port of Seattle Construction Services Agreement*: Entered into on April 17, 2006, this agreement provides payment terms and assignments regarding which entity serves as contract administrator, and which serves as construction manager, for the various contract packages making up the Airport Link project. The agreement also stipulates operating terms applicable after construction. The agreement will not expire as long as Sound Transit operates rail transit systems on the segment.
>
> *University of Washington Master Implementation Agreement*: Entered into on July 2, 2007, this agreement allows Sound Transit entry to the University's Seattle Campus to construct Link light rail; establishes compensation amounts for certain staffing costs, parking mitigation in the amount of $15.2 million, which was paid in 2007 and consideration for easements granted by the University in the amount of $20.0 million, due May 2008. Both parties anticipate additional agreement(s) providing terms for the operation of Link light rail on University property.

Notes to Financial Statements, continued

Land Bank Agreement—Sound Transit entered into an agreement called the *Land Bank Agreement* with the Washington State Department of Transportation ("WSDOT") in July of 2000 and as restated in December of 2003, the purpose of which is to establish a framework within which WSDOT can from time to time convey portions of WSDOT property to Sound Transit and to make other portions of other WSDOT property available for non-highway use by Sound Transit in consideration for Sound Transit's funding of highway purpose improvements. The value of Land Bank credits at December 31, 2007, was $230.8 million and is not recorded in the financial statements. The following table provides information on additions to and uses of credits accruing to the benefit of Sound Transit in 2007 and 2006.

(in millions)	**2007**	**2006**
Balance in Land Bank, beginning of year	$ 150.3	$ 68.1
Credits:		
Totem Lake Freeway Station	-	56.0
Federal Way Direct Access	-	24.6
Lynnwood SR-99 and Lynnwood Transit Center	-	3.7
Ashway Park & Ride	-	1.1
Draws:		
Canyon Park airspace lease	(0.7)	-
Link (Airport alignment)	-	(2.7)
ST Express (Federal Way HOV, S. Everett Freeway Station and Mercer Island Park & Ride)	-	(0.5)
Balance in Land Bank, end of year	**$ 149.6**	**$ 150.3**

Purchases—At December 31, 2007 and 2006, Sound Transit had outstanding construction commitments of approximately $398.9 million and $708.3 million, respectively.

Grants—Sound Transit participates in several federal grant programs that are governed by various rules and regulations of the grantor agencies. Costs charged to the respective grant programs are subject to audit and adjustment by the grantor agencies; therefore, to the extent that Sound Transit has not complied with the rules and regulations governing the grants, refunds of any money received may be required and the collectibility of any related receivable at December 31, 2007 and 2006 may be impaired. In the opinion of management, there are no significant contingent liabilities relating to non-compliance with the rules and regulations governing the respective grants; therefore, no provision has been recorded in the accompanying financial statements for such contingencies.

Claims—In the ordinary course of business, Sound Transit has been named as a defendant in a number of lawsuits relating to personnel and contractual matters. Although the ultimate outcome, if any, of these matters is presently unknown, management has evaluated all claims and potential claims and where that exposure is probable, has reflected in the accounts of the Agency its best estimate. At December 31, 2007, $49.0 million has been recorded in construction in progress and a corresponding liability accrued ($46.0 million at December 31, 2006); however, as these are estimates, these amounts may be subject to change.

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Report on Internal Control Over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance with *Government Auditing Standards*

Audit and Reporting Subcommittee of the Board of Directors
Central Puget Sound Regional Transit Authority:

We have audited the financial statements of Central Puget Sound Regional Transit Authority as of and for the year ended December 31, 2007, and have issued our report thereon dated June 19, 2008. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control over Financial Reporting

In planning and performing our audit, we considered Central Puget Sound Regional Transit Authority's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing an opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of Central Puget Sound Regional Transit Authority's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of Central Puget Sound Regional Transit Authority's internal control over financial reporting.

A control deficiency exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect misstatements on a timely basis. A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects the entity's ability to initiate, authorize, record, process, or report financial data reliably in accordance with generally accepted accounting principles such that there is more than a remote likelihood that a misstatement of the entity's financial statements that is more than inconsequential will not be prevented or detected by the entity's internal control.

A material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the financial statements will not be prevented or detected by the entity's internal control.

Our consideration of internal control over financial reporting was for the limited purpose described in the first paragraph of this section and would not necessarily identify all deficiencies in internal control that might be significant deficiencies or material weaknesses. We did not identify any deficiencies in internal control over financial reporting that we consider to be material weaknesses, as defined above.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether Central Puget Sound Regional Transit Authority's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

This report is intended solely for the information and use of the Board of Directors, Audit and Reporting Subcommittee of the Board of Directors, management, and federal awarding agencies and is not intended to be and should not be used by anyone other than these specified parties.

KPMG LLP

June 19, 2008

KPMG LLP
Suite 900
801 Second Avenue
Seattle, WA 98104

Report on Compliance with Requirements Applicable to Each Major Program and on Internal Control Over Compliance in Accordance with OMB Circular A-133

Audit and Reporting Subcommittee of the Board of Directors
Central Puget Sound Regional Transit Authority:

Compliance

We have audited the compliance of Central Puget Sound Regional Transit Authority with the types of compliance requirements described in the U.S. Office of Management and Budget (OMB) *Circular A-133 Compliance Supplement* that are applicable to each of its major federal programs for the year ended December 31, 2007. Central Puget Sound Regional Transit Authority's major federal programs are identified in the summary of auditor's results section of the accompanying schedule of findings and questioned costs. Compliance with the requirements of laws, regulations, contracts, and grants applicable to each of its major federal programs is the responsibility of Central Puget Sound Regional Transit Authority's management. Our responsibility is to express an opinion on Central Puget Sound Regional Transit Authority's compliance based on our audit.

We conducted our audit of compliance in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*. Those standards and OMB Circular A-133 require that we plan and perform the audit to obtain reasonable assurance about whether noncompliance with the types of compliance requirements referred to above that could have a direct and material effect on a major federal program occurred. An audit includes examining, on a test basis, evidence about Central Puget Sound Regional Transit Authority's compliance with those requirements and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion. Our audit does not provide a legal determination of Central Puget Sound Regional Transit Authority's compliance with those requirements.

In our opinion, Central Puget Sound Regional Transit Authority complied, in all material respects, with the requirements referred to above that are applicable to each of its major federal programs for the year ended December 31, 2007. However, the results of our auditing procedures disclosed an instance of noncompliance with those requirements, which is required to be reported in accordance with OMB Circular A-133 and which is described in the accompanying schedule of findings and questioned costs as item 07-01.

Internal Control Over Compliance

The management of Central Puget Sound Regional Transit Authority is responsible for establishing and maintaining effective internal control over compliance with the requirements of laws, regulations, contracts, and grants applicable to federal programs. In planning and performing our audit, we considered Central Puget Sound Regional Transit Authority's internal control over compliance with the requirements that could have a direct and material effect on a major federal program in order to determine our auditing procedures for the purpose of expressing our opinion on compliance, but not for the purpose of expressing an opinion on the effectiveness of internal control over compliance. Accordingly, we do not express an opinion on the effectiveness of the Entity's internal control over compliance.

Our consideration of internal control over compliance was for the limited purpose described in the preceding paragraph and would not necessarily identify all deficiencies in the entity's internal control that might be significant deficiencies or material weaknesses as defined below. However, as discussed below, we identified a certain deficiency in internal control over compliance that we consider to be a significant deficiency.

A control deficiency in an entity's internal control over compliance exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect noncompliance with a type of compliance requirement of a federal program on a timely basis. A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects the entity's ability to administer a federal program such that there is more than a remote likelihood that noncompliance with a type of compliance requirement of a federal program that is more than inconsequential will not be prevented or detected by the entity's internal control. We consider the deficiency in internal control over compliance described in the accompanying schedule of findings and questioned costs as item 07-01 to be a significant deficiency.

A material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that material noncompliance with a type of compliance requirement of a federal program will not be prevented or detected by the entity's internal control. We did not consider the deficiency described in the accompanying schedule of findings and questioned costs to be a material weakness.

Schedule of Expenditures of Federal Awards

We have audited the basic financials statements of Central Puget Sound Regional Transit Authority as of and for the year ended December 31, 2007, and have issued our report thereon dated June 19, 2008. Our audit was performed for the purpose of forming an opinion on the basic financial statements taken as a whole. The accompanying schedule of expenditures of federal awards is presented for purposes of additional analysis as required by U.S. Office of Management and Budget Circular A-133 and is not a required part of the basic financial statements. Such information has been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, is fairly stated, in all material respects, in relation to the basic financial statements taken as a whole.

Central Puget Sound Regional Transit Authority's response to the finding identified in our audit is described in the accompanying schedule of findings and questioned costs. We did not audit Central Puget Sound Regional Transit Authority's response, and accordingly, we express no opinion on it.

This report is intended solely for the information and use of the Board of Directors, Audit and Reporting Subcommittee of the Board of Directors, management, and federal awarding agencies, and is not intended to be and should not be used by anyone other than these specified parties.

KPMG LLP

June 19, 2008

SUPPLEMENTAL SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
YEAR ENDED DECEMBER 31, 2007

Federal grantor and program title	CFDA number	Federal award expended
U.S. Department of Transportation:		
Federal Transit Administration, Highway Planning and Construction (Flexible Funds from Federal Highway Administration to Federal Transit Administration)	**20.205**	$ 292,490
Subtotal		$ 292,490
Federal Transit Administration, Capital Improvement Grants	**20.500**	90,204,787
Federal Transit Administration, Operating and Capital Assistance Formula Grants	**20.507**	21,313,710
Federal Transit Administration, Job Access—Reverse Commute	**20.516**	34,703
Federal Transit Administration, Alternative Analysis	**20.522**	750,000
Federal Railroad Administration, High Speed Ground Transportation—Next Generation High Speed Rail Program	**20.312**	19,206
Total U.S. Department of Transportation		**$ 112,614,896**
U.S. Department of Homeland Security:		
Office of Domestic Preparedness, Transit Security Grant Program (Passed-through via WA State Military Department)	**97.078**	$ 52,850
Total U.S. Department of Homeland Security		**52,850**
Total Federal Expenditures		**$ 112,667,746**

Note to Schedule of Expenditures of Federal Awards:

The information in this schedule is prepared on the accrual basis of accounting.

SUPPLEMENTAL SCHEDULE OF FEDERAL AWARD FINDINGS AND QUESTIONED COSTS YEAR ENDED DECEMBER 31, 2007

PART I—SUMMARY OF AUDITORS' RESULTS

1. The independent auditors' report on the financial statements expressed an unqualified opinion.

2. There were no significant deficiencies or material weaknesses in internal control over financial reporting identified in the accompanying independent auditors' reports.

3. No instance of noncompliance considered material to the financial statements was disclosed by the audit.

4. There were no significant deficiencies in internal control over compliance with requirements applicable to major federal award programs identified in the accompanying independent auditors' reports.

5. The independent auditors' report on compliance with requirements applicable to each major federal award program expressed an unqualified opinion.

6. The audit disclosed a finding required to be reported under Section .510(a) of OMB Circular A-133.

7. Sound Transit's major program was:

Federal grantor and program title	CFDA number
Federal Transit Cluster	20.500 and 20.507

8. A threshold of $3,000,000 was used to distinguish between Type A and Type B programs as those terms are defined in OMB Circular A-133.

9. Sound Transit did qualify as a low-risk auditee as that term is defined in OMB Circular A-133.

PART II—FINANCIAL STATEMENT FINDINGS SECTION

No matters are reportable.

PART III—FEDERAL AWARD FINDINGS AND QUESTIONED COST SECTION

Finding: 07-01

Federal Program
Link Initial Segment FFGS; CFDA Number 20.500; Award Number WA-03-0142

Federal Agency

U.S. Department of Transportation (DOT) – Federal Transit Administration (FTA)

Criteria

Per Title 29 of the Code of Federal Regulations, *Labor Standards Provisions Applicable to Contracts Covering Federally Financed and Assisted Construction*, Part 5, paragraphs 5.5 and 5.6, the contractor or subcontractor is required to submit to the non-federal entity on a weekly basis, for each week in which any contract work is performed, a copy of the payroll and a statement of compliance (certified payrolls).

Statement of Condition

During our testing of construction contractors for compliance with the Davis-Bacon Act, it was found that Sound Transit did not ensure that their contractors were submitting certified payrolls on a weekly basis. Instead, contractors were submitting weekly certified payroll information, but on a monthly basis. Additionally, it was found that one contractor only submitted certified payrolls once for an entire years' work.

Questioned Costs

Not applicable.

Cause and Effect

Failure to comply with this requirement was caused by Sound Transit not ensuring that contractors abided by the weekly submission requirement. Non-compliance with this requirement could result in reduced future funding for this program.

Recommendation

KPMG recommends that Sound Transit implement a process and related controls to ensure that all contractors submit weekly certified payroll information.

View of Responsible Officials

Sound Transit had interpreted its application of receiving copies of the payroll and statement of compliance with the contractors billings as meeting Title 29, Part 5, paragraphs 5.5 and 5.6 provisions and has, with the exception of the "on call" contractor identified under the statement of condition, diligently complied with these provisions as interpreted and in a manner consistent with other federally funded transit authorities. The one contractor found, where the certified payrolls were not provided until the end of the contract, was an "on call" contractor for which the provisions had not been correctly identified for application.

Based on the interpretation by the auditors that the provisions require receipt of certified payrolls on a weekly basis, and confirmed with the FTA, Sound Transit will immediately request and enforce weekly receipt of payrolls for each week in which any contract work is performed. This will increase the administrative burden both to the agency and its contractors, but Sound Transit is committed to compliance with all laws and regulations. For contractors on federally-assisted "as needed", "on call" and "task order" construction contracts, processes and procedures will be updated to ensure compliance where required under 29 CFT 5.5.